

Client Update

SEC Exams Focus on Whistleblower Compliance by Investment Advisers and Brokers

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This week, the U.S. Securities and Exchange Commission's (the "SEC") Office of Compliance Inspections and Examinations ("OCIE") published a Risk Alert entitled "Examining Whistleblower Rule Compliance." The OCIE Risk Alert notifies registered investment advisers (including advisers to private equity and hedge funds) and registered broker-dealers that OCIE staff is reviewing registered entities for compliance with whistleblower protection regulations. Specifically, OCIE is looking for violations of Rule 21F-17, which prohibits "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . ." ¹ For example, OCIE staff examining an investment adviser may examine employment agreements, severance agreements, and ethics and compliance policies to ensure that they do not inhibit potential whistleblowers.

OCIE's focus on whistleblower issues follows on the heels of several recent SEC enforcement actions alleging violations of Rule 21F-17 and whistleblower protection more broadly, underscoring the heightened attention the agency is placing on the whistleblower provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

BACKGROUND

The Dodd-Frank Act expanded whistleblower incentives and protections in three key areas: first, it sought to protect would-be whistleblowers from actions to impede or interfere with their whistleblowing; second, it created a bounty program for individuals that provide original information that leads to successful

¹ See OCIE, SEC, Risk Alert: Examining Whistleblower Rule Compliance (Oct. 24, 2016), available at: <https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf>.

enforcement actions over a \$1 million threshold; and third, it enhanced anti-retaliation protections for whistleblowers.²

According to this week's OCIE Risk Alert, exam staff will focus on the first key area: protecting would-be whistleblowers that are employed by SEC-registered entities from attempts by those entities to interfere (and from policies and agreements that have the effect of interfering) with the employees' whistleblowing. The protection of potential whistleblowers has also been a recent focus of the SEC's Division of Enforcement, which has brought actions against employers challenging employment and severance agreements that could be read to dissuade whistleblowers (e.g., by denying severance benefits) or prevent whistleblowers from reporting to the SEC (e.g., by prohibiting disclosure altogether). As part of settling these actions, companies have agreed to remediate the issue by, among other things, revising their agreements going forward and providing notice to current and past employees that the company does not prohibit them from communicating with the SEC. It is likely that the same regulatory priorities behind these enforcement actions are driving the OCIE exam scrutiny.

WHAT IS OCIE LOOKING FOR?

The OCIE Risk Alert advises that, in addition to reviewing employment and severance agreements, the exam staff will review registered entities' compliance manuals and codes of ethics for provisions that:

- Purport to limit the types of information that the employee can provide to the SEC;
- Require departing employees to waive their rights to monetary recovery in connection with reporting wrongdoing;
- Require an employee to represent that he or she has not assisted in any investigation involving the registrant; or

² Earlier this month, the SEC brought its first stand-alone whistleblower retaliation case against a gaming manufacturer. See Debevoise & Plimpton LLP, Client Update: SEC Brings First Stand-Alone Anti-Retaliation Enforcement Action Under Dodd Frank (Oct. 4, 2016), available at <http://www.debevoise.com/insights/publications/2016/10/sec-brings-first-stand-alone-anti-retaliation>; see also Debevoise & Plimpton LLP, Client Update: SEC Brings First Anti-Retaliation Enforcement Action Under Dodd-Frank (June 19, 2014), available at <http://www.debevoise.com/insights/publications/2014/06/sec-brings-first-antiretaliation-enforcement-act>.

- Prohibit disclosure of confidential information without prior consent of the registrant or without an exception for *voluntary* communications with the SEC concerning wrongdoing.

The OCIE Risk Alert warns entities that if the exam staff finds documents containing any of the above provisions, it will cite exam deficiencies and potentially refer the matter to the Division of Enforcement.

KEY TAKEAWAYS

We have previously advised employers to review all contracts with their current and former employees to ensure that they do not contain provisions which could be read to discourage or interfere with protected whistleblowing activities;³ we reiterate that advice here for registered entities, including private equity and hedge fund advisers, in light of the increased exam scrutiny discussed in the OCIE Risk Alert. We encourage employers also to review personnel policies, employee handbooks and the like for provisions that may be problematic. As recent enforcement actions make clear, the SEC is willing to enforce the whistleblower protection provisions of the Dodd-Frank Act even absent a substantive violation of the securities laws. The OCIE Risk Alert should put registered entities on special notice that the OCIE exam staff will be reviewing these agreements and other policies and procedures for prohibited provisions, with an eye toward referring any problematic findings to the Division of Enforcement.

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Please do not hesitate to contact us with any questions.

³ See, e.g., Debevoise & Plimpton LLP, Client Update: SEC Brings Action Against Employer for Agreements Requiring Employees to Waive Recovery if They Blow the Whistle (Aug. 11, 2016), available at <http://www.debevoise.com/insights/publications/2016/08/sec-brings-action-against-employer-for-agreements>; Debevoise & Plimpton LLP, Client Update: SEC Brings First-of-Its-Kind Action for Confidentiality Agreements that Discourages Whistleblowing (Apr. 6, 2015), available at <http://www.debevoise.com/insights/publications/2015/04/sec-brings-first-of-its-kind>.